IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 03-33605

CHARLOTTE COPLEY

Debtor

SHERRY L. OWENS

Plaintiff

v. Adv. Proc. No. 03-3171

CHARLOTTE COPLEY

Defendant

M E M O R A N D U M

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RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

This adversary proceeding is before the court upon the Complaint Objecting to Discharge and to Determine Dischargeability of Certain Debts (Complaint) filed by the Plaintiff on October 6, 2003, objecting to the Debtor's discharge under 11 U.S.C.A. § 727(a)(2) (West 1993), or in the alternative, seeking a determination of nondischargeability under 11 U.S.C.A. § 523(a)(2)(A) and/or (4) (West 1993 & Supp. 2004).

The trial was held on April 26, 2004. The record before the court consists of nineteen exhibits introduced into evidence, along with the testimony of the Plaintiff and the Debtor.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(I) and (J) (West 1993).

I

In 2002, the Plaintiff and the Debtor formed Central Mortgage Processing, LLC (Central Mortgage), a limited liability company organized under the laws of the State of Ohio, in which each held a 50% ownership interest.[1] The purpose of the business was to process mortgages on behalf of mortgage brokers. The parties' business relationship continued for approximately five months, until January 2003. During that time, the Plaintiff was primarily responsible for handling the books and accounting of Central Mortgage, including the payment of all expenses, and the Debtor was primarily responsible for the

[1] Nevertheless, the parties did not fully comply with the formalities and statutory requirements associated with the formation of a limited liability company, in that they did not file a Charter, By-Laws, or an Operating Agreement.

actual processing of the mortgage loans. While the Plaintiff wrote almost all of the company's checks, both parties were authorized signators on Central Mortgage's bank account.

On August 14, 2002, the Plaintiff agreed to loan $5,000.00 to the Debtor, and in accordance therewith, the Debtor executed a Promissory Note payable to the Plaintiff, with a maturity date of March 2003. TRIAL EX. 1. The Promissory Note reads as follows:

> I Charlotte Copley will give title to my 1991 BMW 535I to Sherry Ownes [sic] to hold as collateral for a loan in the amount of $5,000.00 for 6 months. Payments shall be no set amount, but monthly payments shall be made. This loan shall be paid in full on or before March 2003. This loan has no interest payments. Payments shall begin in the month of Sept 2002.

TRIAL EX. 1. Pursuant to the terms of the Note, the Debtor physically tendered the Certificate of Title to the 1991 BMW 5351 (BMW) to the Plaintiff, but the Debtor retained ownership and possession of the car at all times. *See* TRIAL EX. 4. Although there is some dispute as to what the parties believed was the basis for the loan, it is undisputed that the Debtor actually used the $5,000.00 to repay a loan to her grandmother and to assist her in avoiding a foreclosure action in Florida.

In January 2003, the parties' business relationship deteriorated, and on January 14, 2003, the Plaintiff sought advice from her attorney regarding a possible end of the business relationship. Thereafter, and unbeknownst to the Plaintiff, on January 15, 2003, the Debtor applied for and obtained a duplicate copy of the Certificate of Title to the BMW from the State of Ohio. TRIAL EX. 11; TRIAL EX. 15. The problems between the Plaintiff and the Debtor culminated in an argument on January 16, 2003, after which the Debtor was escorted from the business premises by the police.

Also on January 16, 2003, the Debtor, through a company check, withdrew $1,900.00 from the bank account of Central Mortgage. TRIAL EX. 8. The Debtor did not discuss this action with the Plaintiff either prior or subsequent to making the withdrawal, and it was not discovered by the Plaintiff for a couple of days, after a personal visit to the bank.

Approximately one month later, in the middle of February 2003, the Debtor moved to Tennessee. The Debtor did not advise the Plaintiff of her move, nor did she provide the Plaintiff with a forwarding address. The Debtor did not repay the Promissory Note,[2] and on February 26, 2003, the Plaintiff filed a complaint against her in the Butler County, Area II Court for Hamilton, Ohio (Ohio Lawsuit). TRIAL EX. 2. In connection with the Ohio Lawsuit, on March 6, 2003, the Plaintiff obtained the Entry of an order for the pre-judgment attachment of the BMW. TRIAL EX. 2.[3]

Upon learning that the Debtor had moved to Tennessee, the Plaintiff filed an action against her in the Knox County General Sessions Court on May 30, 2003. After a hearing before that court, the Debtor consented to a Judgment in the amount of $5,000.00, which was entered against her in favor of the Plaintiff. At that time, however, the Debtor was no longer

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[2] On January 24, 2003, the Debtor obtained and sent to the Plaintiff a certified check in the amount of $100.00, which referenced that it was payment on the Promissory Note for September 2002, October 2002, November 2002, December 2002, January 2003, and February 2003. TRIAL EX. 5. This check was not cashed by the Plaintiff and has not been credited to the balance of the Promissory Note.

[3] This Entry was obtained after the Plaintiff filed a Motion for Order for Prejudgment Attachment, With Affidavit Attached. *See* TRIAL EX. 2. In support of this action, the Plaintiff's attorney also filed a Memorandum in Support, which states that "Plaintiff provided five thousand ($5,000.00) dollars as start-up capital for the business. In return, Defendant executed a promissory note to the Plaintiff in the amount of five thousand ($5,000.00) dollars." TRIAL EX. 2. The Plaintiff testified that this was an incorrect statement that she was not aware had been pled in the Ohio Lawsuit.

in possession of the BMW. In March 2003, while in Florida, the BMW developed serious mechanical problems, including a main seal leak, resulting in a blown head gasket. Consequently, on March 23, 2003, the Debtor traded the BMW to Heath's Toys Auto Sales, Inc., receiving a $2,500.00 trade-in allowance from the BMW towards the purchase of another automobile. TRIAL EX. 17.

The Debtor filed the voluntary petition commencing her Chapter 7 bankruptcy case on June 27, 2003. The Plaintiff's Complaint initiating this adversary proceeding alleges that the Debtor fraudulently obtained a new title to the BMW, even though she had pledged it as security for the Promissory Note, and then traded in the BMW without the knowledge and authority of the Plaintiff. Additionally, the Plaintiff avers that the Debtor obtained the $5,000.00 loan under the false pretenses of purchasing a foreclosure property as an investment for both parties; however, she did not use the funds for that purpose. Finally, the Plaintiff alleges that the Debtor embezzled funds of Central Mortgage in the amount of $1,900.00 to which she was not entitled. Based upon these allegations, the Plaintiff argues that the Debtor's discharge should be denied, or in the alternative, that the Plaintiff is entitled to a judgment against the Debtor and that the judgment be determined nondischargeable. The Debtor filed her Answer on November 26, 2003, denying the allegations of fraud and embezzlement.[4]

[4] The Debtor also filed a Counterclaim in connection with her Answer, suing the Plaintiff and Central Mortgage for an accounting and profits that the Debtor claims were not properly paid to her. In the Pretrial Order entered by the court on February 24, 2004, the Counterclaim was dismissed, as the Debtor no longer has standing to raise the issues. All rights, however, were reserved for the Trustee.

II

Chapter 7 debtors receive a general discharge of all pre-petition debts under 11 U.S.C.A. § 727, unless one of ten express limitations exists. Section 727 provides, in material part:

> (a) The court shall grant the debtor a discharge, unless—
>
> . . . .
>
> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—
>
> (A) property of the debtor, within one year before the date of the filing of the petition[.]
>
> . . . .
>
> (b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter . . . .
>
> (c)(1) The trustee, a creditor, or the United States trustee may object to the granting of a discharge under subsection (a) of this section.

11 U.S.C.A. § 727 (West 1993). These limitations furnish creditors with "a vehicle under which *abusive* debtor conduct can be dealt with by denial of discharge." *Blockman v. Becker (In re Becker)*, 74 B.R. 233, 236 (Bankr. E.D. Tenn. 1987) (quoting *Harman v. Brown* (*In re Brown)*, 56 B.R. 63, 66 (Bankr. D.N.H. 1985)). Because the denial of discharge is harsh and in conflict with the purposes behind Chapter 7, the court construes § 727(a) liberally in favor of debtors, and the party objecting to discharge bears the burden of proof by a

preponderance of the evidence. *Keeney v. Smith (In re Keeney)*, 227 F.3d 679, 683 (6th Cir. 2000); *Barclays/Am. Bus. Credit, Inc. v. Adams (In re Adams)*, 31 F.3d 389, 393 (6th Cir. 1994); FED. R. BANKR. P. 4005.[5]

The Plaintiff objects to the Debtor's discharge under § 727(a)(2)(A), "encompass[ing] two elements: 1) a disposition of property [including transfer or] concealment, and 2) 'a subjective intent on the debtor's part to hinder, delay or defraud a creditor through the act disposing of the property.'" *Keeney*, 227 F.3d at 683 (quoting *Hughes v. Lawson (In re Lawson)*, 122 F.3d 1237, 1240 (9th Cir. 1997)). In order to successfully preclude the Debtor's discharge under § 727(a)(2)(A), the Plaintiff must prove the following: "(1) the debtor transferred or concealed property; (2) belonging to the estate; (3) within one year of filing the petition; (4) with the intent to hinder, delay, or defraud a creditor of the estate." *Clean Cut Tree Serv., Inc. v. Costello (In re Costello)*, 299 B.R. 882, 894 (Bankr. N.D. Ill. 2003). There is no dispute that the Debtor transferred title to the BMW within one year of filing her bankruptcy petition and that the vehicle would have been property of her bankruptcy estate. Therefore, the only question before the court is whether she transferred or concealed the vehicle with an intent to hinder, delay, or defraud the Plaintiff.

Section 727(a)(2)(A) requires proof of actual fraudulent intent, as constructive fraud will not suffice. *E. Diversified Distrib., Inc. v. Matus (In re Matus)*, 303 B.R. 660, 672 (Bankr.

[5] One of the Bankruptcy Code's primary purposes is to provide relief to the "honest but unfortunate debtor" through discharge of debts, allowing a fresh financial start. *Buckeye Retirement Co., LLC v. Heil (In re Heil)*, 289 B.R. 897, 901 (Bankr. E.D. Tenn. 2003).

N.D. Ga. 2004). Accordingly, in order to prevail under this subsection, the Plaintiff must prove that the Debtor possessed an actual intent to deceive. However, because of the inherent difficulties in proving intent, she may use circumstantial evidence, including evidence of the Debtor's conduct, to establish intent. *Hunter v. Sowers (In re Sowers)*, 229 B.R. 151, 157 (Bankr. N.D. Ohio 1998). Additionally, the Plaintiff is not required to prove the Debtor's intent as to all three actions, since proof of any is sufficient. *Cuervo v. Snell (In re Snell)*, 240 B.R. 728, 730 (Bankr. S.D. Ohio 1999).

In order to determine actual intent, based upon circumstantial evidence, many courts consider the following "badges of fraud":

> (i) the lack of adequate consideration for the transfer; (ii) the family, friendship, or close relationship between the parties; (iii) the retention of possession, benefit, or use of the property in question by the debtor; (iv) the financial condition of the party sought to be charged prior to and after the transaction in question; (v) the conveyance of all of the debtor's property; (vi) the secrecy of the conveyance; (vii) the existence or cumulative effect of the pattern or series of transactions or course of conduct after the incurring debt, onset of financial difficulties, or pendency or threat of suit by creditors; and (viii) the general chronology of the events and transactions under inquiry.

Matus, 303 B.R. at 672-73; *see also Stevenson v. Cutler (In re Cutler)*, 291 B.R. 718, 723 (Bankr. E.D. Mich. 2003); *Nashville City Bank & Trust Co. v. Peery (In re Peery)*, 40 B.R. 811, 815 (Bankr. M.D. Tenn. 1984). Additional factors indicating a debtor's actual intent include

> whether the transaction is conducted at arm's length; whether the debtor is aware of the existence of a significant judgment or over-due debt; whether a creditor is in hot pursuit of its judgment or claim and whether the debtor knows this; and the timing of the transfer relative to the filing of the petition.

Adamson v. Bernier (In re Bernier), 282 B.R. 773, 781 (Bankr. D. Del. 2002). If the Plaintiff establishes the existence of badges of fraud, the burden shifts to the Debtor to rebut the

presumption. *Village of San Jose v. McWilliams,* 284 F.3d 785, 791 (7th Cir. 2002); *see also Peery*, 40 B.R. at 815 n.6.

The Plaintiff argues that when the Debtor pledged the BMW as collateral for the Promissory Note, she relinquished her right to transfer the title until the $5,000.00 was fully paid. Although she acknowledges that the title was never "signed over" to her, the Plaintiff argues that she still had an equitable interest in the vehicle and a right to prevent its transfer by the Debtor. The Plaintiff also argues that the Debtor's execution of an application for duplicate title on January 15, 2003, which indicates that the original title was lost or misplaced, evidences her fraudulent intent to conceal the Plaintiff's interest in the BMW so that she could transfer its title in an attempt to hinder or delay the Plaintiff in her position as a creditor of the Debtor.

The evidence does not support a finding that the Debtor should be denied her discharge under § 727(a)(2). There is no question that the Debtor borrowed $5,000.00 from the Plaintiff, and in exchange, gave her the original Certificate of Title to the BMW. Likewise, there is no dispute that the Plaintiff's possession of the Certificate of Title itself did not create a valid lien upon the vehicle. At all times, the Debtor, alone, retained ownership and possession of the BMW, while the Plaintiff merely held possession of the Certificate of Title. With the exception of the existence of the debt owed pursuant to the Promissory Note, in connection with financial difficulties of the Debtor, and the Plaintiff's Ohio Lawsuit having been commenced, none of the "badges of fraud" are present. Additionally, with respect to

those "badges of fraud" that are present, the Debtor has satisfactorily rebutted any presumption of actual fraud on her part.

The Plaintiff testified that she believed that holding the Certificate of Title, without more, actually entitled her to use the car as collateral, such that if the Debtor did not repay the Promissory Note, the Plaintiff could repossess the car and sell it. On the other hand, the Debtor testified that the parties never intended that the Plaintiff have a lien on the BMW, which is supported, in the court's mind, by the fact that the Plaintiff never attempted to have a lien noted on the Certificate of Title. Additionally, the court questions whether the Promissory Note, in and of itself, was sufficient to prove the intent that a security interest in the vehicle was being given by the Debtor to the Plaintiff.

The Debtor readily admits that she submitted the Application for Certificate of Title in order to obtain a duplicate title and that she did not inform the Plaintiff prior to obtaining it. The Debtor also testified that she intentionally applied for the duplicate title because she feared that the Plaintiff might retaliate after their business falling out by attempting to take the BMW, which was her only means of transportation, and she did not want the Plaintiff to be able to take the vehicle from her. The Debtor testified that when she applied for the duplicate title, she did not tell the county court clerk that the title had been lost or misplaced, nor did she inform the clerk that the original Certificate of Title was in the Plaintiff's possession because she was not asked. Also, the Debtor conceded that she did not read the Application before signing it, and she cannot recall whether the handwritten insertions regarding the title being lost or misplaced were on the document when she signed it.

Nevertheless, while the court recognizes that the Plaintiff misunderstood her rights regarding the BMW, the fact remains that the Plaintiff never held any recognizable interest in the vehicle. Ohio, like Tennessee, requires a notation on the Certificate of Title for a lien to be valid. *See* OHIO REV. CODE ANN. § 4505.13(B) (Anderson 2001). The Plaintiff acknowledges that she did not have a lien noted on the Certificate of Title, nor had the Certificate of Title been assigned to her by the Debtor. The Debtor testified that she did not tell the clerk that the original Certificate of Title had been lost or misplaced, and the Plaintiff offered no proof to the contrary.

Moreover, the Plaintiff was unable to show that the Debtor possessed any fraudulent intent when she transferred ownership of the BMW in March 2003, much less meet her burden of proof that the Debtor transferred the vehicle in order to hinder, delay, or defraud the Plaintiff. The Debtor testified that she had every intention of retaining her ownership of the BMW, but when it developed mechanical problems while taking her son to visit his father in Florida for spring break, she did not have the funds to pay for repairs, so she traded in the vehicle for another. This testimony is supported by a Buyers Agreement dated March 23, 2003, evidencing that the Debtor traded in the BMW in order to purchase a 1992 Lexus for $5,000.00, minus the trade-in value of $2,500.00. *See* TRIAL EX. 17.

The transfer did occur after the Plaintiff had commenced the Ohio Lawsuit and after she had obtained an Entry by that court authorizing the pre-judgment attachment of the BMW. However, there is no proof that the Debtor was ever actually served with the Ohio

Lawsuit prior to trading the vehicle. The Complaint was filed on February 26, 2003, and a Summons issued on February 27, 2003, to be served upon the Debtor at her Liberty Township, Ohio address. TRIAL EX. 2. Similarly, the certificate of service on the Plaintiff's motion for the pre-judgment attachment of the BMW lists the same Ohio address. TRIAL EX. 2. These events occurred after the Debtor moved from Ohio to Tennessee on February 16 or 17, 2003, and there is nothing within Collective Exhibit 2 to evidence that the Debtor had actual notice of the Ohio Lawsuit prior to trading in the BMW on March 23, 2003.

Furthermore, there is no evidence to suggest that the Debtor ever intended to conceal her whereabouts, the BMW, or her actions concerning the vehicle from the Plaintiff or any other creditor, even though she did not expressly inform the Plaintiff of her new address or her disposition of the vehicle. To the contrary, the court finds that the Debtor's Statement of Financial Affairs fully discloses her lawsuit with the Plaintiff, the transfer of the BMW, and the Debtor's prior addresses since 2001. *See* TRIAL EX. 19. The disclosures contained therein are further supported by her testimony at trial.

Under the circumstances and based upon the proof presented, the court cannot find that the Debtor possessed the requisite intent to defraud or hinder or delay the Plaintiff when she traded in the BMW in March 2003.

III

In the alternative, the Plaintiff seeks a determination that the Debtor owes her $6,900.00 and that this obligation is nondischargeable. The total requested represents

$5,000.00 for the debt owed to the Plaintiff pursuant to the Promissory Note[6] and $1,900.00 represents the amount withdrawn by the Debtor from the Central Mortgage bank account on January 16, 2003. The bankruptcy court has the jurisdiction and authority to both adjudicate the Plaintiff's claims and award damages if necessary. *See Haney v. Copeland (In re Copeland)*, 291 B.R. 740, 792 (Bankr. E.D. Tenn. 2003) (citing *Longo v. McLaren (In re McLaren)*, 3 F.3d 958, 965 (6th Cir. 1993)).

Clearly, there is evidence to support the Plaintiff's request for a determination that she is entitled to a judgment in the amount of $5,000.00, based upon the Debtor's failure to pay the Promissory Note. Furthermore, the Debtor does not dispute that the Promissory Note has not been paid, and it remains a valid debt owed to the Plaintiff.

On the other hand, the Plaintiff, individually, does not have the authority to recover the $1,900.00 removed by the Debtor from Central Mortgage's bank account on January 16, 2003. The Plaintiff has urged the court to award her a judgment in the amount of the funds withdrawn, arguing that because Central Mortgage did not file an operating agreement or by-laws, it was, in essence, not truly a limited liability company, and thus, the Plaintiff would be entitled to any recovery owed the company. This argument, however, is not supported by the Ohio statutes governing limited liability companies.

All that is required to form a limited liability company in Ohio is the filing of Articles of Organization, setting forth the name and the duration of the company, the name of a

[6] As previously discussed, this debt has been reduced to judgment in the Knox County General Sessions Court.

registered agent, and any other information from the operating agreement that the members so desire. *See* OHIO REV. CODE ANN. §§ 17.04; 1705.06 (Anderson 1999 & Supp. 2002). Once the Articles of Organization are filed with the Ohio Secretary of State, the limited liability company is formed. *See, e.g., McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193, 1200 (Ohio Ct. App. 1999). A limited liability company is a distinct legal entity that may, among other things, sue or be sued, own property, and enter into contracts. OHIO REV. CODE ANN. §§ 1705.01(D)(2)(e); 1705.03 (Anderson 1999). While the members of a limited liability company have the authority to act as its agents, they do so on behalf of the company, not individually. See, e.g., OHIO REV. CODE ANN. §§ 1705.25; 1705.29; 1705.35 (Anderson 1999). Under Ohio law, only the actual corporation or limited liability company is allowed to file suit to recover for injuries sustained or wrongs done to it, and a member or officer does not have a direct or individual action unless "injured in a way that is separate and distinct from an injury to the corporation." *Emerson v. Bank One, Akron, N.A.*, C.A. No. 20555, 2001 Ohio App. LEXIS 5075, at *3 (Ohio Ct. App. Nov. 14, 2001).

The court will not address the question of whether the Debtor was entitled to those funds because the proper party to raise that issue is Central Mortgage, a limited liability corporation, which is a totally separate entity from its members. The court holds that the Plaintiff, individually, does not have standing to seek recovery of the $1,900.00 withdrawn from Central Mortgage's bank account on January 16, 2003, by the Debtor.[7]

[7] Likewise, because the Plaintiff, individually, lacks the standing to personally recover the $1,900.00, the court will not make a determination if the debt is nondischargeable under 11 U.S.C.A. § 523(a)(4).

Even though the court agrees that the Debtor is indebted to the Plaintiff in the amount of $5,000.00, the question remains as to whether the debt is nondischargeable under the Bankruptcy Code. The nondischargeability of debts is governed by 11 U.S.C.A. § 523, which provides, in material part:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—
>
> . . . .
>
> > (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
> >
> > > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition[.]
>
> . . . .
>
> (c)(1) Except as provided . . . the debtor shall be discharged from a debt of a kind specified in paragraph (2) [or] (4) . . . of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2) [or] (4) . . . as the case may be, of subsection (a) of this section.

11 U.S.C.A. § 523. As the party seeking a determination of nondischargeability, the Plaintiff bears the burden of proving all elements by a preponderance of the evidence. *Grogan v. Garner,* 111 S. Ct. 654, 661 (1991). Section 523(a) is strictly construed against the Plaintiff and liberally in the Debtor's favor. *Rembert v. AT&T Universal Card Servs., Inc. (In re Rembert)*, 141 F.3d 277, 281 (6th Cir. 1998); *Copeland*, 291 B.R. at 759.

To support a determination that a debt is nondischargeable under § 523(a)(2)(A), the Plaintiff must prove that the Debtor engaged in conduct that was somewhat "blameworthy," and it may infer fraudulent intent based on a totality of the circumstances. *Copeland*, 291 B.R. at 759 (citing *Commercial Bank & Trust Co. v. McCoy (In re McCoy)*, 269 B.R. 193, 198 (Bankr. W.D. Tenn. 2001)). Misrepresentations and actual fraud fall within the scope of § 523(a)(2)(A). *Copeland*, 291 B.R. at 759.

> "[F]alse pretense" involves implied misrepresentation or conduct intended to create and foster a false impression, as distinguished from a "false representation" which is an express misrepresentation[, while a]ctual fraud "consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another—something said, done or omitted with the design of perpetrating what is known to be a cheat or deception."

Copeland, 291 B.R. at 760 (quoting *Ozburn v. Moore (In re Moore)*, 277 B.R. 141, 148 (Bankr. M.D. Ga. 2002), and *First Centennial Title Co. v. Bailey (In re Bailey)*, 216 B.R. 619, 621 (Bankr. S.D. Ohio 1997)).

In summary, under § 523(a)(2)(A), the Plaintiff must prove that the Debtor obtained money through material misrepresentations that she knew were false or that she made with gross recklessness, that the Debtor intended to deceive the Plaintiff, that the Plaintiff justifiably relied on the Debtor's false representations, and that the Plaintiff's reliance was the proximate cause of her loss. *Copeland*, 291 B.R. at 760 (citing *Rembert*, 141 F.3d at 280). While there is no dispute that the Debtor received the $5,000.00 from the Plaintiff, the Plaintiff cannot meet her burden of proof to support a finding that the $5,000.00 debt owed

pursuant to the Promissory Note is nondischargeable under § 523(a)(2)(A), as the remaining requirements under § 523(a)(2)(A) have not been satisfied.

First, there is no evidence that the Debtor obtained the $5,000.00 through material misrepresentations that she knew were false, nor is there any evidence that she intended to deceive the Plaintiff. In her Complaint, the Plaintiff avers that the Debtor told her that the $5,000.00 loan was to invest in a foreclosure property in Florida, when, in fact, the Debtor used it to pay a debt owed to her grandmother. However, at trial, the Plaintiff testified that she did not really investigate the reasons why the Debtor needed the money. The Plaintiff had just received an inheritance from her deceased ex-husband, and by her own admission, the Plaintiff knew that the Debtor was having financial troubles, and she felt sorry for her. Additionally, the Plaintiff recalled that the Debtor had stated that she needed the money, and she had mentioned, at some point, both the purchase of a foreclosure home in Florida and assisting her grandmother. However, the Plaintiff was unsure whether she knew these things before she made the loan or after.

The Debtor testified that when they first discussed the possibility of going into business together, she informed the Plaintiff that she owed money to her grandmother and that she could not leave her employment until that loan was paid. The Debtor stated that the Plaintiff then offered to give her the $5,000.00 loan, and that the Plaintiff knew at all times the Debtor

would be using the money to pay on her grandmother's home to keep it from being foreclosed upon.[8]

Even with the different recollections regarding whether the Plaintiff knew specifically that the Debtor would be using the $5,000.00 to assist her grandmother, there is clearly no evidence that the Debtor made fraudulent and material misrepresentations to the Plaintiff to induce her into loaning the money.

Material misrepresentations are defined as "substantial inaccuracies of the type which would generally affect a lender's or guarantor's decision." *Copeland*, 291 B.R. at 761 (quoting *Candland v. Ins. Co. of N. Am. (In re Candland)*, 90 F.3d 1466, 1470 (9th Cir. 1996)); *see also* 4 COLLIER ON BANKRUPTCY ¶ 523.08[1][d] (Lawrence P. King ed., 15th ed. rev. 2002) ("A material fact is one touching upon the essence of the transaction."). Intent to deceive requires proof that the Debtor made false representations that she knew or should have known would convince the Plaintiff to loan her the $5,000.00. *Copeland*, 291 B.R. at 765-66. "'Fraudulent intent requires an actual intent to mislead, which is more than mere negligence. . . . A 'dumb but honest' [debtor] does not satisfy the test.'" *Copeland*, 291 B.R. at 766 (quoting *Palmacci v. Umpierrez*, 121 F.3d 781, 788 (1st Cir. 1997)). Fraudulent intent may be inferred by examining the Debtor's conduct to determine if she presented the Plaintiff with "'a picture of

[8] The Plaintiff made allegations in the Ohio Lawsuit concerning the basis of the loan being start-up costs for Central Mortgage. *See supra* n. 3. Even though the Plaintiff acknowledges that this is incorrect, it does conform, somewhat, to the Debtor's testimony that she advised the Plaintiff that she could not go into business unless she was able to first pay off the loan to her grandmother. Additionally, in this adversary proceeding, the basis for the loan was alleged to be a foreclosure property in Florida, which, in actuality, ended up being the basis for the loan.

deceptive conduct . . . indicat[ing] an intent to deceive.'" *Copeland*, 291 B.R. at 766 (quoting *Wolf v. McGuire (In re McGuire)*, 284 B.R. 481, 492 (Bankr. D. Colo. 2002)).

Section 523(a)(2)(A) also requires justifiable reliance by the Plaintiff on any alleged misrepresentation; i.e., she must prove that she actually relied on the Debtor's representations and that, based upon the facts and circumstances known to her at the time, such reliance was justifiable. *Copeland*, 291 B.R. at 767. Justifiable reliance can be found even if the Plaintiff "'might have ascertained the falsity of the representation had [she] made an investigation.'" *Copeland*, 291 B.R. at 767 (quoting *McCoy*, 269 B.R. at 198).

To reiterate, the Plaintiff admitted that she did not fully investigate the purpose of the loan, and she is unsure at what point she learned that the Debtor was using the funds to pay on her grandmother's home. Additionally, at trial, the Plaintiff conceded that she could not say if she would have loaned the money had she known all of the details associated with its use. Because the Plaintiff admitted that she did not fully investigate the purpose of the loan and stated that she is not sure whether her decision to loan the money in hindsight would have been different, there was no misrepresentation in the inducement, there was no justifiable reliance by the Plaintiff upon any representations made by the Debtor, nor is there any evidence that the Debtor committed any sort of fraud against the Plaintiff in obtaining the loan. The $5,000.00 debt owed to the Plaintiff under the Promissory Note cannot be held nondischargeable under § 523(a)(2)(A).

A judgment consistent with this Memorandum will be entered.

FILED: May 10, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 03-33605

CHARLOTTE COPLEY

Debtor

SHERRY L. OWENS

Plaintiff

v. Adv. Proc. No. 03-3171

CHARLOTTE COPLEY

Defendant

J U D G M E N T

For the reasons set forth in the Memorandum filed this date containing findings of fact and conclusions of law as required by Rule 52(a) of the Federal Rules of Civil Procedure, it is ORDERED, ADJUDGED, and DECREED that the Plaintiff's Complaint Objecting to Discharge and to Determine Dischargeability of Certain Debts filed October 6, 2003, is DISMISSED. The Defendant's obligations to the Plaintiff are discharged in their entirety.

ENTER: May 10, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE